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SEC Proposes Additional Disclosures For Target Date Funds

"Target date funds" have become increasingly popular investments for 401(k) and similar participant-directed plans and are often selected as "default" options where participants do not provide investment instructions under DOL's rules for "qualified default investment options" ("QDIAs"). Market losses in 2008, coupled with the increasing significance of target date funds in 401(k) plans, prompted concerns about how target date funds are named, marketed and selected for plans. Federal regulators have responded in several ways.

Last month the Department of Labor ("DOL") and the Securities and Exchange Commission ("SEC") jointly issued an investor education brochure, called an "Investor Bulletin," about target date funds to address investor misunderstandings about the funds and explain features that investors should consider before investing.

On June 16, the SEC took a second step to address concerns about target date funds by proposing amendments to rules governing the naming and marketing of mutual funds under the Securities Act of 1933 and the Investment Company Act of 1940. SEC Rel. No. 33-9126, *published at* 75 Fed. Reg. 35920 (June 23, 2010). For purposes of the rules, a target date fund would be defined as an "investment company that has an investment objective or strategy of providing varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures that changes over time based on an investor's age, target retirement date or life expectancy." This definition is intended to encompass target date funds marketed as retirement plan savings vehicles – including target date funds that may qualify as QDIAs under DOL's regulations – but omits some QDIA requirements (such as the requirement that the fund apply generally accepted investment theories) and thus applies more broadly.

The SEC proposal would make the following three changes –

- The proposed rules would require a fund that includes a target date in its name to disclose, together with the first use of the fund's name, the fund's asset allocation at its target date, or if the target date has already passed, the fund's current allocation. This is intended to address concerns that investors may not understand that target date funds for the same retirement year may have different asset allocations and that many are still significantly invested in equities at the target date. In this regard, while some target date funds have "landing points" (at which the asset allocation becomes static) at or near the target date, the SEC found that a significant majority have landing points that are ten or more years after the target retirement date in the fund's name.
- Advertisements for a fund that includes a target date in its name would be required to include a table, chart or graph depicting the fund's allocations among types of investments (e.g., equity, fixed income securities and cash) over the life of the fund or at periodic intervals (no longer than 5 years) – including the allocation at inception, the target date and the landing point. A statement must be presented with the table, chart or graph to help explain asset allocation changes over time, the landing point (including the number of years after the target date that the landing point would be reached), and whether the manager may make changes to the intended allocations without a shareholder vote.
- The proposed rules would mandate certain statements in marketing materials, designed to address concerns that target date funds are offered as a "simple solution" and encourage investors to select a fund solely based on the investor's retirement date. Statements would be required that advise investors –
    - to consider, in addition to age or retirement date, other factors, including risk tolerance and individual financial situation, and
    - that the fund is not "guaranteed" and it is possible to lose money by investing, including at and after the target date.

The SEC proposes to make these new disclosure rules effective for materials used 90 days or more after publication of final rules, although certain changes would be effective immediately when final rules are issued.

Importantly, these rules will only apply to investment companies regulated by the SEC, and thus would not directly apply to target date investment options that are structured as collective trust funds or separate accounts managed for corporate and similar plans. However, we believe the SEC's disclosure rules generally provide relevant guidance for presenting target date investment options to plan participants, even where the option is not an investment company directly regulated by the SEC.

We understand that DOL will issue additional guidance regarding target date funds, including guidance for plan fiduciaries selecting these funds for their plans (expected soon) and amendments to the QDIA regulations (expected later this year) that will address how these options are described to plan participants.

Comments on the SEC proposals are due by August 23.

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